State of California

Rating
General Obligation Bonds .... A+

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New Issue Details
$500,000,000 Various Purpose General Obligation bonds for bids on Oct. 22. Bonds will be due June 1, 1996–2026; bonds due on and after June 1, 2008, are callable beginning June 1, 2006, at 101%. Bidders may specify term bonds with mandatory redemption.

October 21, 1996

Outlook

California's economy continues to strengthen, more rapidly than had been anticipated. Employment currently is above the pre-recession high and the unemployment rate is gradually decreasing. Financial operations have benefited from the rebound and by the end of 1995–96, the previously accumulated general fund deficit was virtually eliminated. The inclusion of the school "loan" settlement in the general fund has created a deficit in its undesignated surplus position, but this will gradually reduce as a plan is in place. The financial improvement has continued into 1996–97, with first quarter revenues exceeding projections. In addition, borrowable resources are expected to be sufficient at year-end to cover the general fund cash deficit by an ample margin. Debt position remains favorable. Although it is expected that California's finances will remain stable as the economy further firms, the state will continue to suffer the restrictions imposed by restructuring initiatives, including mandating of strict property tax limits and the share of the budget which must be devoted to education. Pending initiatives would impinge on local financial flexibility and their passage could place more pressure on the state. These structural problems will continue to limit flexibility at the state level.

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Rating Comment

The new issue includes $371.1 million bonds to fund outstanding commercial paper notes and $128.9 million in new money. The state embarked on a commercial paper program earlier this year (rated 'F-1+') for capital purposes. The program is limited to $1 billion outstanding and as of Oct. 1, the finance committee had authorized $3.577 billion commercial paper notes to be issued. Net tax-supported debt after the sale will amount to $20.4 billion, or $680 per capita and 2.7% of personal income. Authorized but unissued general obligations will total $7.3 billion and $2.1 billion additional such bonds will be on the November ballot.

The general fund's operations have been skewed in recent years by devolutions to local units and off-budget "loans" to school districts. Beginning in 1989–90, a series of revenue shortfalls depleted fund balance and, as the recession was longer and harsher than anticipated, continued over-estimation of revenue created a large general fund deficit. The stated deficit reached about $3.9 billion at the end of 1991–92. It was technically reduced by the "loans" to schools ($1.1 billion) arising from the mandated portion of the budget for that purpose, made on the basis of estimated revenues which exceeded actual collections. The "loans" were placed off-budget but remained a component of the cash deficit. Financial statements have been revised to include the "loans" in fund balance as agreement has been reached to fund them over eight years, with the state paying $935 million and the schools, $825 million. Since all payments are made from state monies, the entire amount is shown as a reservation of fund balance which has the effect of increasing the undesignated deficit from $628 million at the end of 1994–95 to $2.555 billion; total fund balance remains about the same. In 1995–96 the share of revenues again has caused complications. Since revenues were over estimates, the schools are entitled to receive about $1.1 billion additional, the reverse of the earlier situation.

California has achieved general fund operating surpluses for each of the past four years and another is anticipated in 1996–97. In 1995–96, revenues were about 5% over budget and expenditures rose accordingly. The operating surplus of $696.7 million was a little below expectations and adjustments were made to opening balance, so the deficit (exclusive of school loans) was not quite extinguished. The ending fund balance was $219 million, of which $306 million was reserved for encumbrances, $1.559 billion reserved for school loans, to leave an undesignated deficit of $1.646 billion. The budget for 1996–97 envisions revenue growth of 3.3%, with the sales tax increasing 5.0% and the personal income tax, 6.5%. Bank and corporation taxes decline a little as a result of rate reductions. Expenditures rise about 4%, with almost all the growth in education. Some $700 million in federal aid is expected in new money related to illegal immigrants which creates some vulnerability. Of $660 million in health and welfare cuts requiring federal action, only $360 million is now expected. The governor has submitted a plan dealing with training pursuant to the new welfare bill and work is underway for submission of a full plan. The budget expects an operating surplus of $392 million and $305 million as a reserve. Economic assumptions underlying the budget appear reasonable, with employment increasing about 2.6% and personal income, 6%. For the first quarter of the fiscal year, revenues are 3.8%, or $415 million, above estimates. Of the total, $157 million is from estate taxes, which will be attributable to 1995–96. Excluding these items, revenues are 2.3% above estimates.

Employment growth is in line with expectations, rising 2.5% in 1995, and 2.8% in June 1996 when compared with the same month a year ago. In June, services and construction were each up 4.4%, trade 2.5%, and manufacturing 1.3% while government was flat and FIRE off slightly, 0.4%. From 1990 to 1995, manufacturing employment fell 15% (high technology, 30%), or a job loss of 305,000; construction lost 119,000 jobs. Due to the strong 10% growth in services, total job loss was reduced to 223,000. This gives some indication of the recent changes in the state's economy. In June 1996, reported employment is almost 1% over 1990 while the 1995 figure was still almost 2% below that level. Personal income performance was relatively strong in 1995, with the state increasing 6.6%, or 110% of the national gain. On a per capita basis, the state rate was 6.0%, or 120% of the nation. Per capita personal income was $23,699, or 104% of the U.S., ranking the state twelfth. In first quarter 1996, the state rate of personal income growth slowed to 4.7%, while the U.S. rate was 5.0%.

For further details, please refer to Fitch Research dated March 7, 1996.